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УДК 338.45

# FORMATION OF MARKET VALUE OF THE COMPANY

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The term "company value management" is getting more and more topical these days. Value management is fundamentally different from the planning systems of the 1960-s. It is no longer the exclusive function of top management, it is aimed at stimulating decision-making at every level of the company. Value management initially implies that top down command-and-control style of decision-making is not effective enough, especially applied to large diversified corporations. Consequently, all level managers have to learn to take value indicators in consideration to make more rational decisions. Value management requires adjusting the balance sheet together with the profit-and-loss statement and keeping a reasonable balance of long-term strategy and short-term objectives of the company activity. The company with value management proper implemented and organized earns great profit. This type of management is basically a constant restructuring aimed at reaching the maximum value. And this method really works. It makes economic efficiency grow higher. There is special literature proving the advantages of the value indicators over other company parameters. Managers of Russian corporations switch from such indices of efficiency as profit and profitability to the foreign concept of value management. Therefore we will dwell upon defining the value determining factors in more detail.

To form/create the company value one should in the first place understand what elements of the company's day-to-day operations and investment decisions mostly influence its value. The proper approach to defining the value determining factors helps a manager (and executives of a business unit): firstly, to fully understand the mechanism of value creating and value maximizing in their business unit; secondly, to prioritize value factors and to define where to allocate (or reallocate) the monetary resources, and, thirdly, to perceive the superior priorities of the company and adjust to them.

In the context of this article "Value factor" means something that the company efficiency depends on, for example, production efficiency or customer satisfaction. The measurement units of value factors are called key performance indicators (KPIs). Among these, in particular, are capacity utilization and preservation rate of consumer circle compound. A set of KPIs is used to set the target standards as well as to evaluate the performance results.

The formation of market value of shares can be influenced by various factors of different character: macro level factors reflecting political, economic, legal, infrastructural, social and cultural as well as moral and ethical peculiarities of the country of a company's origin; "medium" level factors reflecting the condition of the industry a company functions in; micro level factors reflecting the financial and economic state of a company, its production potential, its competitive environment, the corporate and organizational structure of its management as well as special features of shares' (blocks of shares) characteristics and circulation.

To correctly define value factors a company should observe three important principles:

1. *Value factors should be directly connected to the shareholder value formation and to certain degree should be brought to knowledge of every level of the company including the lowest one.* The direct connection of value factors to the shareholder value formation has two advantages. Firstly, it allows putting together the objectives of different levels of the company. When average executives and managers of a business unit hold one opinion on how day-to-day operations of their company affect its value, they can coordinate their plans and valuations thus eliminating the contradiction of objectives they set for themselves in their work.

Secondly, managers have the possibility to keep the reasonable balance of short term objectives and long term strategy and order of priority for different value factors. In the face of a hard decision to be made managers can use the long-term value as a decision-making criterion and necessary grounding for the stock market. It shall be noted that the shareholder value formation does not withdraw other important objectives of the company, such as labour safety, safety of produced goods and environment protection. On the contrary, these aspects can also be included in the system of value factors defining and result evaluation. It is important to set clear rules determining how and under what circumstances these objectives have priority over shareholder value maximization not to interfere with the general value-based course.

2. *When setting the target standards and evaluating the performance results one should denominate value factors as in financial KPIs so as in operational KPIs.* Very often companies analyze value factors by breaking down the invested capital profitability into its financial components. This is a good start but the process by itself will not give you the whole idea of value factors. The thing is that managers cannot directly influence financial ratios, they can only do it through operational instruments. Consequently managers should take one step forward. For instance, a retailer selling equipment (equipment distributor) would like to know how to increase his EBITDA. He should first break it down to its components: gross profit, storage costs, delivery costs and other trade, general and administrative expenses. Then he should define the factors determining each kind of expenses: thus, delivery cost can be represented through a number of trips for one transaction, expenses of one transaction and a number of transactions. This level of detail allows managers to analyze specific measures aimed at improving the company's results.

The operational activity parameters are very useful as leading indicators. Financial ratios as such cannot warn managers about coming problems. For example, the invested capital profitability of a division can increase for a short period of time just because management team cannot keep the necessary level of assets or necessary investment. If these managers are asked to make a report on operational indicators such as equipment maintenance, fleet renewal or increase/replace of assets, we will see that the invested capital profitability increase is rather evanescent.

3. *Value factors should reflect both current activity and long-term growth prospects*. Though many mature companies and companies with declining business activity pay basic attention to their current activity, success-oriented companies should always look for growth opportunities. Consequently, the value factors analysis should define the parameters determining both the increase of profitability over the capital expenses and the current invested capital profitability increase. In our example with the retailer of equipment this can be the increase of number of stores to be opened this or that year or number of new types of goods launched to the market. However the growth factor cannot be always measured by so simply measurable parameters such as a number of stores. So in certain cases it is more correct to use design indicators. For example, a new production process can be the source for a metallurgical company growth, its value factor being the production process introduction term. In other cases qualitative indicators are of more use. For example, the producer of consumer goods should estimate his ability of grasping the market trend using the following scale: excellent, good, satisfied, bad.

The above said suggests that each company division (economic or business unit) should have its own set of KPIs. Of course, there is always a chance that the head office can give in to temptation to apply unified pattern to all the company divisions, but as a rule it is absolutely senseless for all the parameters except the most general financial indicators. Even if two business units belong to the same industry they should rather consider their own individual KPIs if their day-to-day operations are significantly different. For example, a division with excellent operational results and high profit should rely on growth-based KPIs while a less profitable division should be guided by expenses-based KPIs.

It should also be noted that a business unit should have a limited set of operational indicators. Managers should regularly evaluate the results according to these indicators combined with other value factors that serve as secondary diagnostic criteria, to see the general picture of the unit performance and underlying causes of possible problems. We can conclude from experience that five – ten (maximum 20) KPIs are enough for that. If a company uses more than 20 KPIs it will likely face difficulties choosing those to pay basic attention to.

The process of defining value factors has several stages. First a company should define the connection of the operational elements of its business and the (value) creation process itself. Group discussion and brainstorming can be used to come to a single opinion. Then they should define the most influencing factors and evaluate the sensitivity of the business unit value to the change of each of these factors. After that a limited number of selected factors should be analyzed to define their "real" potential to implement it in every action aimed at improving the company performance. In conclusion the company should make a list of key value factors indicating the potential of each of them.